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Commercial real estate is one of many possibilities buyers have for investing capital. By treating the commercial real estate buying decision as an investment, these buyers are unlike residential buyers who often make purchase decisions by relying, perhaps unwittingly, on less rational dynamics like emotion. Instead, commercial buyers are focused on the potential economic value of the purchase relative to other investments. This decision context parallels the prevalently studied context in entrepreneurship where individuals must decide if a specific set of circumstances represents an attractive business opportunity for them or their firm. Building on this parallel, what we know about how entrepreneurs make decisions about opportunities, broadly defined, presents interesting insights regarding how commercial real estate buyers are likely to make decisions about real estate transactions.

In that spirit, we make connections between recent research that documents entrepreneurs’ use of rule-based thinking to make opportunity evaluation decisions and the decision making of commercial real estate buyers. Specifically, we provide an overview of rule-based thinking, its use in opportunity evaluation and then conceptualize commercial real estate transactions as resting, at least in part, on rule-based thinking around specific attributes of the property. In doing so, we endeavor to provide insight for real estate professionals concerned with understanding how commercial buyers evaluate properties as investment opportunities, and ultimately, make purchase decisions about specific properties.

What is Rule-Based Thinking?

Real estate purchase decisions are complex and mentally taxing (Perry and Lee 2012) and thus necessitate a systematic way to think about the decision. Cognitive science research finds that in situations such as these, rule-based thinking is a mechanism that allows individuals to cognitively frame decision problems via deliberately engaging in mental simulations of cause-and-effect relationships. These simulations flow from rules of reasoning derived from one’s knowledge base (e.g., lessons from education, day-to-day experiences, and interactions with others). In that way, rules are analytical knowledge structures that take the form of “if $s_1$, then if $a_1$, then $c_1$” where $s$ represents a setting condition, $a$ represents an antecedent, and $c$ is a consequent” (Frye, Zelazo and Palfai
1995, p. 486). Rules do not have to come from direct experience but can be socially learned from “other individuals, the media, or other cultural sources” (Smith and DeCoste 2000, p.112) and are applied to specific circumstances via cognitive comparison between the decision rule and the target.

**Opportunity Evaluation as Rule-Based Thinking**

Our recent study published in *Journal of Management Studies* builds on the rule-based thinking approach and documents entrepreneurs’ use of rule-based thinking in opportunity evaluation decisions (Wood and Williams 2014). Specifically, we developed an on-line experiment using a technological innovation as a business opportunity and then manipulated specific characteristics of the opportunity. The entrepreneurs participating in this study evaluated a series of opportunity profiles where the characteristics of the opportunity varied for each profile. Sixty-two experienced entrepreneurs, defined as an individual who has started at least one business intended to be his/her primary source of income, participated in the experiment and completed a total of 498 opportunity evaluation decisions. This technique allowed us to identify entrepreneurs’ decision rules-in-use, as they actually make decisions about the attractiveness of opportunities.

Analysis of the data revealed that entrepreneurs consistently used rules about opportunity novelty, resource efficiency, and the worst-case scenario to evaluate opportunities. Concretely, entrepreneurs evaluated opportunities significantly more positively when the opportunity had high novelty or high resource efficiency (i.e., optimal deployment of resources such as capital), and less positively when it had a severe worst-case scenario. The worst-case scenario indicates the severity of the downside risk for the opportunity under consideration. Interestingly, the negative effect of worst-case scenario rule was approximately double that of the positive effect for novelty or resource efficiency indicating that even for entrepreneurs, who are typically characterized as risk-seeking (Stewart and Roth 2001), the downside (worst-case scenario) mattered the most in their opportunity evaluation decisions. Building off this finding for the importance of the worst-case scenario, when considering the worst-case scenario alongside the otherwise positive influence of opportunity novelty and resource efficiency, worst-case scenario moderated the positive influence of these other two rules on entrepreneurs’ opportunity evaluations. Specifically, the worst-case scenario overwhelmed the otherwise positive effects of novelty and resource efficiency.

Further, we examined the importance of different levels of knowledge about the opportunity market and the opportunity technology. We discovered that higher levels of opportunity market and opportunity technology knowledge strengthened, rather than weakened, the negative influence of the worst-case scenario on entrepreneurs’
opportunity evaluations. This highlighted that more knowledgeable entrepreneurs took the worst-case scenario about an opportunity even more seriously than those with less knowledge. Taken together, these findings suggest that entrepreneurs’ experienced-based rules regarding the worst-case scenario are “driving the bus” and, in so doing, it is steering them away from the opportunity when the worst-case scenario is severe. This is especially true if the individual has extensive knowledge about the market or technology, presumably because this knowledge allows him or her to paint an accurate picture of the worst that can happen. These findings demonstrate the salience of rule-based thinking as a cognitive structure used to evaluate business opportunities.

**Commercial Real Estate as Opportunity Evaluation**

To the extent that commercial real estate represents a business opportunity, we believe there are important lessons to be learned by real estate professionals from the Wood and Williams (2014) study. Specifically, the fact that two opportunity characteristics (novelty and resource efficiency) positively charge entrepreneurs’ evaluations of opportunities indicates that, all else equal, entrepreneurs prefer opportunities that are more novel and/or make the best use of available resources. For real estate professionals, this suggests that an effective sales strategy would be to quantify and emphasize the uniqueness of the property (i.e., its novelty) and/or the optimal use of resources associated with property as compared to others on the market (i.e., its resource efficiency). One could, for example, provide the buyer information that demonstrates the novelty of the location or a unique feature such as clear span construction. Likewise, a savvy broker may develop a spreadsheet that has current listings along with recent prior sales that demonstrates the efficient use of resources, manifest as return on investment or similar measures of efficiency, if the target property is purchased over other alternatives.

Another key lesson that comes from the study is that the worst-case scenario is a powerful rule in opportunity evaluation decisions. Specifically, the worst-case scenario had a negative effect on evaluation and the effect was nearly three times as large as the positive effects of novelty and twice that of resource efficiency, to the point of negating the positive effects of these variables when the three are considered in unison. The insight is that buyers are likely to place a much heavier weight on the possible negatives associated with the worst-case scenario rather than the positives associated with other factors. Therefore, real estate professionals may consider finding ways to reduce the downside associated with the worst-case scenario. Therefore, we suggest that rather than simply focusing on the positive aspects of a property, as is common practice, brokers may
want to have explicit discussions with clients about the worst-case scenario as the research suggests that it is a dominant consideration. Doing so allows one to understand how the client is conceptualizing the worst-case scenario. This understanding is critical because the client may have a very different picture of the worst-case scenario than the broker, and if this is due to extensive knowledge of the market, the research suggests that negative effects of the worst-case scenario become especially powerful. Once a broker understands the client’s vision of the worst-case scenario, he or she can then work to find ways to help reframe the scenario by altering perceptions or by mitigating the concerns of the buyer. Mechanisms, such as contract clauses, hold outs, and creative financing arrangements may be used to minimize concerns over the worst possible outcome. The research suggests that doing so will increase the odds that the target property will be evaluated favorably, which in turn increases the odds a transaction will take place.

**Conclusion**

Commercial real estate is a specialized investment opportunity and should be treated as such. Rule-based thinking plays an important role in opportunity evaluation decisions, and savvy real estate professionals can use this understanding to positively influence clients’ transaction decisions. By providing clients with valuable information about the novelty, resource efficiency, and worst-case scenario associated with specific opportunities, commercial agents can establish themselves as advisors in the evaluation process, thereby increasing the value created for both buyers and sellers.

**Recommended Reading**


**References**


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